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A Review of Property Taxation in Oregon and Report on State Measure No. 5 "Continues Tax Reduction Program"

City Club of Portland (Portland, Or.)

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**A REVIEW OF PROPERTY TAXATION IN OREGON
AND
REPORT ON
STATE MEASURE NO. 5
“CONTINUES TAX REDUCTION PROGRAM”**

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To the Board of Governors,
The City Club of Portland:

I. ASSIGNMENT AND SCOPE OF RESEARCH

In January 1979, your Committee was appointed to study and report on the tax relief measures that would be before the Oregon Legislature during its 1979 Session. At that time, it appeared that one or more of the measures might be placed on a special election ballot in May 1979. As the legislative session progressed, it became clear that no special election would be held in May 1979, and that there would be no tax relief measure on any Oregon ballot before May 1980. Your Committee, therefore, was asked to remain in existence to study any tax relief measures that might appear on the 1980 primary or general election ballot, whether they were generated by the Legislature or by initiative petition.

This report is concerned primarily with two tax relief bills approved by the Oregon Legislature in 1979: HB 2540 and HB 2589. Several parts of these bills have already gone into effect; others will become effective only if State Measure No. 5 is approved by the voters at the 1980 primary election. No other tax relief measures will be on the May primary ballot, and it is not yet known whether any other tax relief plans will be on the November general election ballot.

II. SUMMARY OF 1979 TAX RELIEF BILLS

(1) HB 2540 made significant changes in the property tax laws, and introduced a limitation on the growth of governmental spending at the state level. The major portion of the following report is concerned with this bill.

(2) HB 2589 made permanent reductions in the state income tax. Part VI of this report discusses the changes made by this bill.

(3) HB 2186 provided for a one-time distribution of approximately \$70 million of General Fund surplus to individual income taxpayers. In August 1979, each taxpayer received a refund of 9% of his or her Oregon income tax for 1978. That part of the 1979 legislative tax package is now history, and it will not appear on the 1980 primary ballot. That bill is therefore not discussed further in this report.

Measure 5 on the 1980 primary ballot will carry the ballot title reproduced at the beginning of this report. In essence, Measure 5 asks voters whether those portions of HB 2540 and HB 2589 that provide tax reductions or tax relief should be continued after 1980.

Its purpose, as stated on the ballot is:

“Purpose: Approval of this measure would allow continuation of the following tax reduction program after 1980:

- (1) Limit on property assessment increases to a state-wide average of five percent by class.
- (2) Reduction of the property taxes on owner-occupied principal residences. Equivalent relief to renters.
- (3) Reduction of personal income tax.
- (4) Increased tax relief under Homeowner and Renter Relief Program (HARRP).
- (5) State expenditure limitation.”

III. SOME DEFINITIONS

One of the most troublesome aspects of any discussion of property taxes is that the words and phrases used in the laws are confusing and frequently misunderstood. Your committee concluded that it would be useful to define at the outset some of the most common and important terms used in this report. It should be emphasized that the follow-

ing definitions apply to these terms as they are used in Oregon law; some of these terms may have different meanings in other states. Moreover, the following definitions apply to these terms as they are usually used, and certain exceptional uses have been omitted for the sake of brevity and simplicity.

1. *Taxing Unit.* Any governmental body that has authority to levy a property tax.
2. *Tax Base.* The total dollar amount of tax that any taxing unit can collect from property taxes in any year without approval from voters living within the unit's boundaries. The familiar "6% limitation" found in Article XI, Section 11 of the Oregon Constitution applies to the tax base, as discussed in Part V (B) of this report.
3. *Levy.* The amount of money to be collected from property taxes in any year, including the tax base and any additional amounts approved by voters.
4. *True Cash Value.* The amount of money any property is worth on the January 1 assessment date, according to the appraisals of the county assessor. By statute (ORS 308.205), this value is supposed to equal actual market value.
5. *Assessed Value.* The dollar amount assigned to any property for purposes of computing the taxes due on it. From 1967 to 1979, ORS 308.232 required all real or personal property to be assessed at 100% of its True Cash Value. HB 2540 changed this, so that beginning January 1, 1980, assessed values of owner-occupied residential properties will be computed by taking a percentage, expected to be less than 100%, of True Cash Value. Assessed values for all other properties will be computed by using a different, usually higher, percentage of True Cash Value. In each case, the percentage used will be uniform across the state. See Part V (E) of this report.
6. *Tax Rate.* The levy divided by the total assessed value of all property on which a tax is paid, usually expressed in dollars per thousand. In other words, the tax rate for any taxing unit is computed by taking the amount of money the unit has approval to collect from taxes (its levy), and dividing that figure by the total assessed value of the property that is taxed.
7. *Inflation Indicator.* In general, the ratio obtained by dividing the Portland Consumer Price Index for September of any year by that for September 1978, or later year if the tax base is increased.
8. *Population Indicator.* In general, the ratio obtained by dividing the population of a taxing unit as of July 1 of the prior fiscal year, by the unit's population as of July 1, 1978, or later year if the tax base is increased. Section 27a of HB 2450 provides that the Population Indicator may not fall below 1.000.
9. *Homestead.* The principal residence owned and occupied by the taxpayer and located in Oregon, including land area up to one acre or the minimum required by zoning, whichever is greater.
10. *Adjusted Levy.* With minor exceptions, the "adjusted levy" will be the portion of the tax levy of a unit that qualifies for state relief under HB 2540. In most years the "adjusted levy" will be the levy for 1979-80, minus any tax levied for bond principal and interest, multiplied by the product obtained by multiplying the "inflation indicator" by the "population indicator." If the tax base of a taxing unit is increased by the voters, the new base becomes the "adjusted levy" for the year levied. "Adjusted levies" thereafter are that tax base multiplied by the product obtained by multiplying the "inflation indicator" by the "population indicator."

IV. BACKGROUND OF OREGON PROPERTY TAXES

Property taxes provide the largest single source of support for schools, fire protection districts, and some other special districts in Oregon. County governments collect property taxes for all taxing units within their jurisdictions, but they retain a relatively small proportion of them for their own use. For all of Oregon's cities and counties taken together, property taxes provide less than 30% of total revenues. In the case of the State of Oregon,

no revenues at all for the operation of state government are derived from property taxes. State government is supported by the income tax, by transaction taxes on items such as liquor, gasoline, and cigarettes, and by various types of federal transfers

In the case of most local taxing units, the percentage of total budget met by property taxes has been declining, largely because of the rapid growth of revenue transfers from one level of government to another in recent years.¹ Transfers of funds from state and federal governments to local taxing units have been increasing more rapidly than property taxes have been. The net effect of this has been that income taxes have borne an increasing share of total governmental spending on all levels. Nevertheless, public schools in Oregon still rely on property taxes as their largest single source of revenue.

Efforts to limit the growth of property taxes in Oregon are not new. In 1916, Oregon voters amended the state constitution to limit the taxing power of taxing units by putting a 6% ceiling on the growth of the tax base in any one year, except when increased by vote of the people. At that time, property taxes provided virtually all of the revenue for the operation of state and local government in Oregon. In the 1920s, Oregon voters rejected several attempts to institute an income tax, which had been proposed as a means of providing property tax relief. In 1929, the Legislature tried again, and passed the "Property Tax Relief Act of 1929," which (with companion legislation) imposed personal income and corporate excise taxes. Opponents succeeded in temporarily blocking the measure by gaining enough petition signatures to place it on the general election ballot in 1930, but the voters approved it in that election, and the personal income tax became a permanent fixture of Oregon tax law. From 1930 until passage of HB 2589 in 1979, the personal income tax remained essentially unchanged.

In contrast, there has been almost constant tinkering with the property tax, and few legislative sessions have passed without some modifications to methods of assessment and collection of property taxes. Efforts to produce large-scale reform or reduction of property taxes, however, have generally been unsuccessful. In 1966, an initiative measure to limit property taxes to 1½% of true cash value failed to make it to the ballot because the required number of signatures had not been validated before the filing deadline. In November 1968, a 1½% property tax limitation did appear on the ballot, but was defeated by a margin of almost two to one. In 1969, the Legislature proposed a sales tax as a means of property tax relief, but it was overwhelmingly rejected by the voters in a special election.² In November 1972, voters rejected a proposed constitutional amendment that would have prohibited the use of property taxes to finance public schools. In a special election in May 1973, voters rejected the "McCall plan," which included a property tax limitation and a revision in the system of school finance. Another proposed revision of the system of public school finance, popularly known as the "safety net" plan, was defeated in a special election in 1977.

In the election of November 1978, Oregon voters were faced with two property tax measures: Measure 6, a 1½% property tax limitation, and Measure 11, a more complex proposal adopted by the Legislature in special session, which would have put a ceiling on the growth rate of state governmental operating expenses, and which provided that the state would pay one-half of the property taxes imposed upon owner-occupied principal residences in the state, up to a maximum of \$1,500. The City Club adopted the majority report of its study committee in October 1978, and recommended a no vote on Measure 6 and a yes vote on Measure 11. At the general election in November, both measures were defeated.

In the meantime, beginning in 1971, the Legislature acted on its own to provide property tax relief to low-income home owners and renters, by adopting and later expand-

¹The impact of these revenue transfers on the budgets of different taxing units varies widely, and we have not attempted to illustrate these different effects.

²Five prior attempts to institute a sales tax in Oregon had been rejected by the voters between 1933 and 1947.

ing the Homeowner and Renter Relief Program (HARRP). In addition, during the 1970s the Legislature provided significant state aid to community colleges and increased basic school support. All of these acts had the effect of shifting a portion of the cost of local government (especially the cost of schools) from property taxes to income taxes.

A. Introduction

V. OPERATION AND EFFECT OF HB 2540

The basic thrust of HB 2540 is to provide property tax relief, not by imposing a ceiling on tax rates, in the manner of California's Proposition 13, but by having the state pay a portion of each homeowner's property taxes out of the state's general fund revenues. In developing the tax relief package, the Legislature decided that if the state were to fund a portion of local property taxes, a limit to that participation had to be established. At the same time, the Legislature wanted to leave control of local government revenues in the hands of local voters, and to give voters greater flexibility in controlling local government expenditures.

Therefore HB 2540: (1) limits the levy growth that the state will partially fund without approval by the voters of an increased tax base; (2) requires a taxing unit to obtain voter approval, in a separate ballot question, for any amount over the adjusted levy, and provides that the state will not fund any part of this amount over the adjusted levy; (3) limits the number of tax elections; and (4) requires taxing units which have obtained approval of excess levies to give voters an opportunity to adopt new tax bases incorporating the excess levies, which would have the effect of raising the adjusted levy so as to provide state funding for a portion of the entire amount.

B. Understanding the Tax Base

It is important at the outset to understand what a tax base is, how it increases, what it includes, and what the voter has actually been voting on in levy elections, sometimes referred to as "budget elections."

Taxing units are allowed to levy a certain increased level of tax each year without voter approval. Article XI, Section 11 of the Oregon Constitution provides that unless authorized by vote, the levy cannot be in excess of the tax base. Voters can be asked to approve a new tax base in any primary or general election, but in the absence of new voter approval, the tax base is defined, by the Constitution, as the amount obtained by adding six percent to the total amount of tax levied by a taxing unit, exclusive of special or serial levies and bond requirements, in any one of the last three years in which a tax was levied. In other words, even without voter approval, the tax base may rise by 6% each year.³ Approval of a special levy does not affect the tax base.

Thus, when voters are asked to approve a levy in what is commonly referred to as a budget election, they are not voting on the budget or the total amount of funds needed by the local taxing unit, but only that part of the levy outside the tax base. The budget election vote also does not affect bond requirements or serial levies, because when the voters give initial approval to a bond issue or serial levy, they are automatically authorizing all subsequent annual levies necessary to fund the initial proposal. Thus, the special or excess levy which must be submitted to the voters in a budget election consists only of the amount of money needed by the local taxing unit over and above (1) the tax base, which may include a 6% increase over the preceding year, (2) previously approved serial levies; (3) amounts needed to make payments on outstanding bond obligations; and (4) revenues received from sources other than property taxes.

³ The original wording of Article XI, Section 11, as adopted in 1916, provided that a unit's tax base could rise by 6% over the preceding year's levy. This resulted in shrinking tax bases for many units during the Depression, since some units imposed levies lower than their existing tax bases. As a result, Article XI, Section 11 was amended in 1932 to allow a unit to use the levy imposed in any one of the three immediately preceding years as the base to which the 6% increase could be applied.

A simplified example may help illustrate how the process worked prior to the adoption of HB 2540. Assume that School District has a \$500,000 tax base in 1977, and that all of its revenues come from property taxes. School District's Board approves an operating budget for 1978 of \$1,000,000. Since the 1978 tax base will be \$530,000 (\$500,000 plus 6%), School District must submit to the voters a special levy of \$470,000 (i.e., \$1,000,000 minus \$530,000). School District must also raise \$200,000 to meet bond requirements, and a \$100,000 serial levy for new buses had been previously approved. If the voters approve the operating levy of \$470,000, the actual amount of taxes levied will be \$1,300,000 (tax base + special levy + bond requirements + serial levy).

Now assume that during 1978, the cost of goods and services purchased by School District has increased and population growth has forced School District to hire more teachers, bus drivers, and cooks. As a result, School District's Board concludes that it must have an increase of \$150,000, or 15%, in its 1979 operating budget, to \$1,150,000. Its tax base for 1979 will increase by only \$31,800 (i.e., 6% of \$530,000) to \$561,800, so it must submit to the voters a special levy of \$588,200 (\$1,150,000 less \$561,800). If that levy is approved, the total amount of taxes levied in 1979 will be \$1,450,000. (For the effect of these levies on a homeowner's tax bill, see Section D below.)

Many taxing units have a tax base which is too low to meet their annual budget needs, and must therefore submit a large portion of their budget to the voters for approval every year. The principal reason for this is that these units operate on tax bases that have not been increased by the voters since they were established many years ago, and have consequently grown by no more than 6% each year. Because of population growth and inflation, the demands for local governmental expenditures have grown much faster than 6% per year. Thus, each year, any taxing unit that does not have an adequate tax base must ask the voters to approve a special levy in order to have enough money to operate, even if it does not increase its level of program and activities.

C. Understanding the Assessment Process

Probably the most misunderstood aspect of Oregon's property tax system is the relationship between the assessed values of property and the amount of property tax to be levied or collected. Except for the 6% annual increase in the tax base allowed by the Constitution, the total amount of property tax imposed by a taxing unit cannot be increased without voter approval. If a governing body wants to increase expenditures to a level higher than the revenues it will receive from the tax base (plus any other available revenues), it must request additional taxing authority from the voters. Without voter approval, there can be no increase in total property taxes above the 6% limitation, even if assessed values of property increase dramatically.

The assessment procedure functions only to determine how the tax burden is to be divided up among various property owners; it has nothing to do with establishing the overall level of taxation itself. Assessed value may be unfair as between two particular pieces of property, but every county has a Board of Equalization to hear appeals of questionable appraised values and to adjust them when appropriate. Consequently, if the critic of higher assessed values is actually complaining about high property taxes, the criticism might more properly be directed elsewhere, to spending or budgetary decisions themselves.

In a nutshell, Oregon's process for determining property values calls for the appraisers in the county assessor's office to determine the fair market value (or true cash value) of each piece of taxable property. This fair market value may not necessarily correspond to the amount of any particular sale during the year. When sales of similar properties are compared, it is clear that some people pay too much and others get a bargain. Therefore, part of the appraisal process is to find typical values related to the characteristics of the property.

For residential properties, county assessors use the "market" approach of valuation, by which sales prices are related to objective characteristics of properties that have been

sold. The market approach is not well suited to industrial properties, or to many commercial or rental properties, because such properties are not bought and sold with the same frequency as homesteads. For commercial properties that have rental data, valuation is usually computed on the basis of the income generated by the property. For other commercial and industrial property, replacement cost less depreciation is the usual basis for computing value.

All properties must be physically appraised at least once every six years. To accomplish this, each county is divided into six reappraisal areas, one of which is physically reappraised each year.

The assessed values of the properties in the other five districts are "trended" by increasing the previous year's true cash value by a "trending factor." The trending factor is derived from ratio studies. For residential properties, the sales prices for all "arms-length" sales in a reappraisal area are compared to the true cash values for the properties that were sold. This results in a mass of individual ratios that vary rather widely, depending upon whether the purchaser paid too much or got a bargain. These ratios are arranged in an array from the smallest to the largest. The ratio that is most typical of the array determines the trending factor.

A similar attempt to determine fair trending factors is made for other types of property, such as multi-family residential, commercial, and industrial, although much less data is available for such properties.

D. . Understanding Tax Rates

As noted in Part III of this report, the tax rate is the figure obtained by dividing the levy by the total assessed value of all property on which a tax is paid. In the example of the School District set out in Section B above, the tax rate in 1978 would be determined by dividing the total levy of \$1,300,000 by the total assessed value of the taxable property within the District. Assume that the assessment procedures described in Part C above have resulted in a determination that the taxable property within School District has a total assessed value in 1978 of \$90,000,000. The tax rate for 1978, for School District only, will therefore be \$14.44 per thousand dollars of assessed value (i.e., \$1,300,000 divided by \$90,000,000). Homeowner A, whose homestead is assessed at \$50,000 in 1978, will therefore pay to the County a property tax of \$722 for School District. Homeowner B, whose homestead is assessed at \$35,000, will pay to the County a property tax of \$505.40 for School District.

Assume further that market demand by 1979 has pushed market values for good quality homes ahead by 20%, but values of homes in less desirable neighborhoods have increased by just 7%. Industrial and commercial property values have also risen, and new buildings and other improvements have been added, so that the county assessor determines that in 1979, the total assessed value of taxable property in School District has risen by 22%, to \$110,000,000. The tax rate for 1979 will be \$13.18 per thousand (i.e., \$1,450,000 divided by \$110,000,000). Homeowner A, whose property was assessed at \$50,000 in 1978, now faces a 20% jump in the assessed value of her property in 1979, to \$60,000, but the taxes she pays to School District have risen by only 9.5%, from \$722 to \$790.80, because the tax rate went down. The assessed value of Homeowner B's property has risen by 7%, from \$35,000 to \$37,500 but his taxes have actually decreased by 2.2%, from \$505.40 to \$494.25, because of the decrease in the tax rate. (Note that in these years, the assessed value equalled true cash value. That will not be true under the new law, as explained in Section E, below.)

As this illustration shows, it is possible for tax rates and tax liabilities to decrease even when property assessments increase. On the average, therefore, an increase in tax liability on a particular piece of property is more likely to be caused by increased expenditures by local taxing units than by increases in assessed values.

E. Effects of HB 2540 on Assessed Values

Although most comment relating to the 1979 legislative tax package has focused on tax relief to individuals, significant changes to the assessment system were also made.

One change improved the uniformity of the appraisal system, by ensuring that all true cash values will be established as of the same date each year. Prior law allowed trended properties to be valued as of March and those physically appraised to be valued as of the following January. This disparity meant that the true cash values of the latter were increased by ten months' additional inflation, as compared to the former.

A second change modifies the concept of uniform taxation of all properties. For the past several years, when all real property was supposed to be assessed at its actual market value, true cash value of all Oregon residential real property tended to rise much faster than true cash value for all other Oregon property, simply because the actual market value for homes has been increasing at a more rapid rate than market values for most other real estate. Figures from the Legislative Revenue Office show that in the three years ending January 1, 1979, total assessed value for residential property increased by an average of 19.3% per year, while total assessed value for all other property increased by an average of 8.6% per year. The result has been that homeowners, as a class, have borne a gradually increasing share of the total property tax burden, as compared to owners of all other properties. HB 2540 is intended to change this, by slowing the rate of increase in assessed values for homesteads.

HB 2540 accomplishes this movement away from uniform taxation by dividing all property subject to tax into two classes: homesteads and all other property. The state-wide total assessed value for all properties in each class of property will be permitted to increase no more than 5% from any one year to the next. If true cash value for all properties in either class increases by more than 5% over the total assessed value of the properties in that class in the preceding year, the Oregon Department of Revenue will determine the appropriate ratio (of assessed value to true cash value for that class) that must be applied in order to limit the increase to 5%. Every county assessor will apply that ratio to the true cash value of each parcel of property in the county within that class, and place the resulting lower figure on the tax rolls as the assessed value for that year.

In early 1980, the county assessors and the Department of Revenue conducted a study that found that the average increase in the true cash value of all homesteads in the state between January 1, 1979, and January 1, 1980, was 24.6%. Therefore, the true cash value of an average homestead in Oregon, on January 1, 1980, was 124.6% of what it was on January 1, 1979. However, since HB 2540 limits the average assessed value increase to 5% per year, the average assessed value on January 1, 1980, can only be 105% of what it was a year earlier. The ratio of 124.6% to 105% is 84.2%, and the latter figure has been certified by the Department of Revenue to all county assessors for use in determining 1980 assessed values. Thus, if a homestead anywhere in Oregon has a true cash value in 1980 of \$50,000, the county assessor must fix its assessed value at \$42,100 (i.e., 84.2% of \$50,000).⁴

In the case of Homeowner A, it was assumed in the example set out in Section D, above, that the true cash value of her homestead rose by 20% from 1978 to 1979, from \$50,000 to \$60,000. Under the prior law, the assessed value of her homestead also rose from \$50,000 to \$60,000 in those years. If in the next year market values rose by another 20%, the true cash value of her homestead in 1980 will increase from \$60,000 to \$72,000 (i.e., \$60,000 + 20%). The assessed value of her homestead, however, will increase by only 1%, from \$60,000 to \$60,624 (i.e., 84.2% of \$72,000).

It is possible, of course, for the assessed value of any particular homestead to increase by more than 5% in any year, for it is the increase in *total* statewide assessed values (or,

⁴The Department of Revenue study also showed that the true cash value of all non-homestead property increased by an average of 19.8% between January 1, 1979 and January 1, 1980, resulting in a ratio of 87.6% (i.e., 105% divided by 119.8%). Thus, a business property that has a true cash value of \$50,000 in 1980 will be assessed at \$43,800 (i.e., 87.6% of \$50,000).

seen from a different perspective, the increase in the *average* assessed value for the whole state) that is limited to 5%. Thus, if the true cash value of Homeowner A's property had risen by 25% from 1979 to 1980, from \$60,000 to \$75,000, then its assessed value in 1980 would be \$63,150 (i.e., 84.2% of \$75,000). That represents a 5.25% increase over the 1979 assessed value of \$60,000. Without the ratio limitation imposed by HB 2540, however, the assessed value would have risen by the same 25% that true cash value rose.

By the same token, it is also possible for the assessed value of a homestead to decrease under the new law, even if its market value increases. Thus, if the true cash value of Homeowner A's property had risen by 10% from 1979 to 1980, from \$60,000 to \$66,000, then its assessed value in 1980 would be \$55,572 (i.e., 84.2% of \$66,000). That represents a 7.4% decrease from the 1979 assessed value of \$60,000.

In general, increases in assessed values greater than 5% will occur wherever market values are increasing more rapidly than the state-wide average. As noted above, the average increase in true cash value for all homesteads in the state between January 1, 1979 and January 1, 1980 was 24.6%. In Multnomah County, however, the average increase in market value for homesteads during the same period was 31.1%, and it is estimated that the assessed value of an average homestead in Multnomah County will therefore increase by 10.4% in 1980 over the 1979 level. Comparable figures for Clackamas County in the same period are a 28.9% average market value increase and an 8.5% average assessed value increase; for Washington County, the figures are 29.2% and 8.8%, respectively. In contrast, it is estimated that the assessed value of the average homestead in 12 other counties will decrease in 1980.

F. Effects of HB 2540 on Homeowner Property Taxes

HB 2540 provides that the state will pay 30% of the homeowner's "qualified" property tax, up to a maximum payment of \$800. The property tax that qualifies for state payment does not include taxes that are levied for payments of bond principal or interest, nor does it include taxes used to pay for levies voted by the people that exceed the taxing unit's adjusted levy. Only the tax on the portion of property actually used for the homestead, up to a maximum area of one acre (or the minimum zoning, whichever is greater), qualifies. Any portion of the property taxed as farm or forest land or used for rental purposes does not qualify. (A homeowner may rent his residence during a period of temporary absence, however, without disqualifying the property.)

Homeowners must apply for relief for the 1979-80 tax year and for each year in which the property changes hands. If a property owner fails to notify the State of changes in property use, and as a result receives relief payments on ineligible property, the owner must pay back the full amount of the relief payments plus a penalty equal to 20% of those payments.

The State will make payments directly to residential renters of up to \$400, based on 4.7% of their rent during the calendar year. (The Legislature determined that a 4.7% refund of rental payments would provide relief to renters equivalent to the relief given to homeowners by the 30% payment of qualified taxes on homesteads.) Renters must apply for relief annually.

Homeowner payments will be made directly to taxing authorities unless the relief application was not processed in time for the 1979-80 tax rolls, in which case the 1979 payments will be made directly to the homeowner. Renter payments will always be made directly to renters.

In future years, state payments under this program will be further limited, in the second year of each biennium, by the availability of funds. If the Legislature has not appropriated enough money to make the full payments under the applicable formula, then the amount credited to each homeowner and renter will be reduced proportionately.

G. Effect of HB 2540 on Levy Election Procedures (the "A and B Ballot")

In the case of many taxing units, the adjusted levy which is subject to the state's 30% funding exceeds the unit's tax base. This is because the unit's original adjusted levy, as defined in HB 2540, included special or serial levies in addition to the tax base, or because the effect of the population and inflation indicators has been to make the increase exceed 6% per year. In future years, any special or serial levy that exceeds the tax base will still have to be approved by the voters, just as in previous years, whether or not that special or serial levy is within the adjusted levy.

In many cases, this will result in an election ballot that contains two different questions, sometimes referred to as Ballot A and Ballot B. Ballot A will ask voters to approve or disapprove any special or serial levy that is within the adjusted levy, subject to the 30% funding by the state. Ballot B will ask voters to approve or disapprove any special or serial levy that exceeds the adjusted levy, which must be financed completely by the local taxpayer with no state participation. As a rule, Ballot A will ask, in effect, whether voters want to continue spending at the existing level (including, of course, the 6% annual increase in the tax base, plus the increases allowed by the population and inflation indicators), while Ballot B will ask whether voters want to increase spending beyond the growth factors allowed under Ballot A.

These separate questions may appear on the same ballot, but approval of Ballot B is not effective unless and until Ballot A is approved. Ballot A can be voted on as often as elections are held, but Ballot B can be presented for voter approval only twice after approval of Ballot A. Defeat of Ballot B in any year does not prevent the taxing unit from presenting an identical proposal to the voters in a subsequent year in conjunction with a new Ballot A.

H. Requirement for New Tax Base Elections

HB 2540 also requires taxing units to submit a new tax base for voter approval under certain circumstances. Any school district that is levying in excess of its tax base in an odd numbered year must seek a new tax base in the following even numbered year. All other local government units levying in excess of their tax base in three of the four years preceding an even-numbered year must also seek a new tax base in that even-numbered year.⁵ Thus the voter will have the opportunity to approve a new tax base for any district that regularly operates in excess of its tax base, thereby bringing the tax base into line with current levies. A principal incentive for voter approval of a new tax base in this situation, of course, is that the state will finance 30% of the new base, whereas it would not help finance special levies which exceeded the adjusted levy. However, the sections of HB 2540 which impose the requirement of new tax base elections are not part of Measure 5 and will therefore remain in effect even if the voters reject Measure 5.

I. Effects of HB 2540 on the HARRP Program

The Homeowner and Renter Relief Program ("HARRP") was begun by the Legislature in 1971 as a means of providing property tax relief to low-income homeowners and renters. HB 2540 expands the HARRP program by raising the maximum eligible household income from \$16,000 to \$17,500 and by raising the maximum refund for each household income level from \$655 to \$750 for homeowners, and from \$328 to \$375 for renters. This new refund schedule applies to payments made in October 1979 based on 1979 HARRP returns. Taxpayers with 1978 income between \$16,000 and \$17,500 were given until April 1, 1980, in which to file for the refund.

After the state pays up to 30% of a homeowner's residential property taxes, qualified homeowners and renters can still file for HARRP refund on their remaining tax bill. The amount of HARRP refund will be the lesser of the remaining property tax or the maximum allowable HARRP refund for each household income level, as set out in a new re-

⁵Under Article XI, Section 11 of the Oregon Constitution, a new tax base proposal can be presented to the voters only at a regular primary or general election in even-numbered years.

fund schedule in HB 2540. Homeowners and renters on the low end of the income scale will not receive significant additional benefits under the new law, because they already had most or all of their property taxes paid under HARRP.

It is estimated that the combined effect of the expanded HARRP program and of the state funding of 30% of qualified property tax will be that about 30% of all homeowners will pay no property tax, compared to about 18% under the former HARRP program. If these property-tax-free homeowners vote in large numbers in future tax elections, their impact could be quite significant, although it is impossible to predict whether their "immunity" from property tax will affect their votes on measures that would increase property taxes for other people.

J. Effects of HB 2540 on State General Fund Expenditures and Revenues

The limitation imposed by HB 2540 on the rate of growth of Oregon General Fund expenditures and revenues is possibly even more significant for the future of taxation in Oregon than the increased state financing of property tax or the indexing of the personal exemption to the income tax (See Part VI of this Report).

1. The Expenditure Limitation

Under the new law, appropriations for general state governmental purposes for any biennium may increase over such appropriations for the prior biennium, but only by the same percentage by which the sum of Oregon personal income for the two calendar years immediately preceding the start of the new biennium increased over the sum of such income for the two calendar years preceding the start of the prior biennium. The appropriations which are subject to this limitation do not include debt service or funds necessary for any of the new tax relief, except the homeowners and renters property tax relief plan.

The effect of this expenditure limitation can perhaps best be appreciated by looking at what would have happened during the past decade, if the limitation had been in effect. The operation of the limitation is illustrated in the following step-by-step example:

(1) For the 1971-73 biennium, total General Fund appropriations were \$783 million.

(2) To compute the allowable growth in General Fund expenditures for the next biennium, 1973-75, start by computing the total personal income for the two calendar years preceding the base biennium. The total personal income for Oregonians in 1969 and 1970 was \$14,891,000,000.

(3) Next compute the total personal income for the two calendar years preceding the start of the next biennium. The total personal income for Oregonians in 1971 and 1972 was \$17,897,000,000.

(4) The percentage growth of personal income between 1969-70 and 1971-72 was 20.2%.

(5) Therefore, if HB 2540 had been in effect, General Fund appropriations for the 1973-75 biennium should have been no higher than \$941 million (\$783 million + 20.2% of \$783 million).

(6) Actual General Fund appropriations in 1973-75 were \$1,015 million, or 29.6% more than they had been in the preceding biennium, and \$74 million more than they would have been had HB 2540 been in effect.

The following table capsulizes what the spending limitation effect of HB 2540 would have been since 1971:

Biennium	Total Personal Income for 2 Preceding Calendar Years (millions)	Increase in Personal Income Over Prior Biennium	General Fund Limit if HB 2540 Had Been in Effect (millions)	Actual General Fund Appropriations (millions)	Increase in Appropriations Over Prior Biennium
1971-73	\$14,891	%—	\$ —	\$ 783	%—
1973-75	17,897	20.2	941	1,015	29.6
1975-77	22,700	26.8	1,287	1,443	42.2
1977-79	27,989	23.3	1,779	2,127	47.4
1979-81	35,809	27.9	2,720	2,478	16.5

In this table, "Actual General Fund Appropriations" excludes amounts that were appropriated for property tax relief, other than HARRP. (It also excludes the amount paid out in the August 1979 income tax rebate.) The fourth column reflects the limit computed separately for each biennium, and does not reflect what the cumulative effect would have been had HB 2540 been in effect throughout the decade. If HB 2540 had become effective for the 1973-75 biennium and had stayed in effect, appropriations for 1979-81 would have been limited to \$1,881 million, or \$597 million less than what has actually been appropriated for this biennium (excluding the new tax relief adopted by the 1979 Legislature). Actual General Fund appropriations for 1979-81 were lower than the limit that would have been permissible if HB 2540 had been in effect because the Legislature deliberately imposed such a limit on itself in 1979. When the August 1979 income tax refund and the funds allocated to pay the 30% property tax and 4.7% rent relief are added to the General Fund figure, the total comes considerably closer to the hypothetical \$2,720,000,000 limit.

2. *The Revenue Limitation*

The revenue limitation does not guarantee that state government will never again experience an unusually large surplus,⁶ but it does guarantee that taxes will be reduced in the biennium following any biennium in which actual revenue exceeds estimated revenue by more than two percent.

The revenue limitation is keyed to the two revenue estimates that the executive department is required to make after the Legislature has adopted final revenue laws and adjourned. The first is an estimate of the revenue for the biennium from corporate income and excise tax sources. The second is an estimate of all other revenue for General Fund purposes. Any manipulation of these figures, so as to guarantee either a small or large surplus, seems unlikely in view of the fact that the second estimate is made soon after the latest estimates furnished to the Legislature while it was in session.

If actual corporate income and excise tax revenue during the biennium exceeds the estimate of such revenue by more than two percent, the entire excess over that estimate will be credited against those corporate taxes for taxable years beginning in the calendar years in which the biennium ended. Similarly, if revenue from all other sources exceeds the estimate of that revenue by more than two percent, that entire excess will be credited against the personal income tax for the year in which the biennium ended. Thus, the refund of the General Fund surplus, by means of tax credits, will not affect state revenues for the biennium in which the excess appeared. The credits will, however, reduce revenue in the subsequent biennium, unless tax rates are changed.

For example, in 1979 the total revenues for the 1979-81 biennium, excluding corporate excise and income taxes, were estimated on May 11, 1979, to be \$2,465.7 million. This was the final estimate given to the legislators, and so formed the basis (together with the estimate of corporate excise and income taxes, provided to them on the same date) for their final appropriations decisions for the 1979-81 biennium. After the Legislature adjourned, those revenues for the biennium were estimated to be \$2,419.8 million. If those revenues for the biennium turn out to exceed \$2,468.2 million (that is, 102% of \$2,419.8 million), the entire amount above \$2,419.8 million will be allowed as a credit on personal income tax returns in the following year. Similar calculations would be used for corporate taxes.

VI. OPERATION AND EFFECT OF HB 2589

House Bill 2589 reduces Oregon income taxes in several ways. First, it increases the Oregon personal exemption from \$750 to \$1,000. Second, it increases the maximum Oregon deduction for federal income taxes paid from \$5,000 to \$7,000. These two changes

⁶The Oregon Constitution in effect mandates that there be *some* surplus. Article IX, Section 2 prohibits the state from engaging in deficit spending, and since the Legislature budgets for two years in advance, it must allow for some margin of error in case revenues are not as high as forecast.

are effective for taxes paid for 1979 and 1980. If the voters reject Measure 5 at the May 1980 election, these changes will be discontinued, and the figures will revert to \$750 and \$5,000, respectively, for 1981 and subsequent years.

A third change made by HB 2589 will not become effective until 1981, and will not become effective at all unless approved by the voters in May 1980. It provides that the Oregon personal exemption will be increased each year by the rate of change in the Portland Consumer Price Index. In 1981, for example, the Portland Consumer Price Index as reported in July 1981 will be divided by the Index as it stood in July 1980. The resulting "indexing factor" will be multiplied by \$1,000 (the amount of the personal exemption for 1980), and the product will be the new personal exemption applicable for individual income tax returns filed for 1981.

VII. ARGUMENTS ADVANCED IN FAVOR OF MEASURE 5

1. HB 2540 provides for favored tax treatment of owner occupied residential properties, in order to stop the trend of recent years which saw an increasing percentage of total property taxes being paid by owners of residential property. (In contrast, California's Proposition 13 and its Oregon parallel, Measure 6, which was defeated in the 1978 general election, favored commercial and industrial property over residential property.)

2. HB 2540 gives tax relief directly to renters. (Proposition 13, in contrast, left it up to the discretion of landlords whether to pass any tax relief on to their renters.)

3. HB 2540 increases property tax relief under HARRP, by raising the refund levels and the maximum household income level for eligible recipients.

4. HB 2540 limits the rate of growth of state government spending from the General Fund.

5. HB 2540 provides that surpluses in the state General Fund will be credited against future income taxes.

6. HB 2540 does not take away from local taxing units any revenue sources that had been previously approved by the voters.

7. Under HB 2540, local voters will remain free to raise their own property taxes if they choose to do so.

8. Through the A and B ballot device established by HB 2540, voters will have the opportunity to approve either the entire amount requested by a taxing unit (the A and B ballots together), or only a portion of it (the A ballot alone).

9. HB 2589 provides significant income tax relief to taxpayers at all income levels.

VIII. ARGUMENTS ADVANCED AGAINST MEASURE 5

1. HB 2540 gives no relief to commercial and industrial property owners, thereby reducing the attractiveness of Oregon to industry.

2. HB 2540 is incomplete because it does not control tax rates, thus leaving room for continued increases in property taxes.

3. HB 2540 and 2589 divert too much money into tax relief and away from needed state programs.

4. HB 2540 and 2589 are regressive in that they give too much relief to persons in upper income brackets.

5. The so-called "A and B ballot" system established by HB 2540 is too complex and will confuse the voters.

6. Instead of simplifying Oregon's tax structure, the Legislature has further complicated it. The tax laws were already difficult to understand, and now even fewer Oregonians will be able to understand them.

7. By splitting all taxable properties into two classes for assessment purposes, HB 2540 abandons Oregon's nationally-praised concept of uniform assessment, which had been carefully developed over several decades.

8. The limitation on the rate of growth of appropriations for the state general fund imposed by HB 2540 will not provide an effective check on the growth of state expenditures.

9. Under HB 2540, the cost of determining which residential properties are "homesteads" so as to qualify for partial state payment of property taxes, and the cost of updating that determination each year for properties that have changed owners or that are no longer "homesteads," will be considerable and unproductive.

IX. CONCLUSION

Your Committee has spent many months analyzing HB 2540 and HB 2589 and evaluating their impact on Oregon's taxpayers. Committee members have discussed at length the arguments for and against the bills set out in the preceding sections, and recognize that each of the arguments may be persuasive to certain voters, depending largely upon their own beliefs as to what the proper goal of tax laws should be. Some members of the committee would have preferred less complicated bills, and some would have preferred that the tax relief provided by the bills had been distributed differently. There is a special concern, based on the experience of the March 1980 levy elections in various districts, that the A and B ballot device may prove unsatisfactory, and may have to be modified in a future legislative session.

Nevertheless, your Committee believes that HB 2540 and HB 2589 were responsible attempts at providing meaningful property and income tax relief to nearly all Oregonians. The bills were the products of careful legislative deliberation, and they were passed by the Legislature with substantial bipartisan support. Certainly other choices could have been made, but since any tax reform measure must represent compromise choices between important and competing interests, probably no measure would be completely satisfactory to any element of the population. Our conclusion is that the bills deserve the City Club's support.

X. RECOMMENDATION

Your Committee recommends a "YES" vote on State Measure No. 5 at the May 20, 1980 primary election.

Respectfully submitted,
T. Shannon Buckley
M. Alexis Dow
Don A. Ellis
Gaulda L. Hahn
M. David Hooff
Rodney Lewis, Jr.
Raymond L. Miller
Robert L. Weil
Charles F. Hinkle, **Chairman**

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APPENDICES

A. Persons Interviewed

Jean F. Anderson, Assistant Director, Oregon Department of Revenue
George J. Annala, Oregon Tax Research
Terry W. Drake, Economist, Legislative Revenue Office
Gilbert Gutjahr, Director, Multnomah County Tax Supervising and Conservation Commission
Lee Johnson, Executive Assistant to the Governor
Bill Marble, Oregon Department of Revenue
Richard A. Munn, Legislative Revenue Officer
Hardy Myers, Speaker, Oregon House of Representatives

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